Intelligent Financial Solutions

Valuation for IRC 409A

IFS Consulting & Investments is an independent Israeli multi-disciplinary consulting company, specializing in financial, economic and business consulting services. Our in-depth experience, wide-ranging client base and diverse expertise have positioned us at the head of our field. We provide innovative services for some of Israel's leading corporate and government entities.

At **IFS** we have a rich experience in providing **independent valuation services** to more than 100 privately held companies across various industry sectors, at all stages of development; whether it is an early stage start up with no product revenues, or a well-established company with significant profitable history, planning for an IPO. Moreover, IFS is a leading provider of **IRC 409A valuation services** to growing **private companies**, while performing numerous 409A valuations since Section 409A was added to the Internal Revenue Code over six years ago. Given our professional expertise, wide industry knowledge, access to a variety of standard industry databases we are able to provide fair and most importantly, objective valuations.

409A Explanation

During the past six years, the rules governing deferred compensation have changed dramatically due to the Internal Revenue Code Section (IRC) 409A, which sets out more stringent guidelines for **private companies when issuing stock options, shares** and other forms of non-qualified deferred compensation. In order to comply with **IRC 409A**, privately held companies need to get their valuations done by independent appraisers to arrive at the **Fair Market Value (FMV)** of their **common stock** and fix the exercise price of stock options. Noncompliance with IRC 409A can lead to acceleration of taxable income, penalty taxes, company withholding tax issues and potential exposure for board members. Additionally, **non-compliance** could impact the marketability of a business to investors and/or acquirers.

What makes 409A valuations different from other valuations? Most valuations begin and end with an estimate of the value of the total enterprise and its equity; however a 409A valuation focuses on valuing the **common stock** of the company. As a consequence a 409A valuation needs to incorporate the financial features of a company's capital structure to allocate the value of the equity among different classes of shareholders.

The Importance of the Service

Section 409A generally provides that a "nonqualified deferred compensation plan" must comply with various rules regarding the timing of deferrals and distributions. The penalty for non-compliance is severe in that all amounts deferred under the plan for the current year and all previous years become immediately taxable, plus a penalty tax.

Furthermore, Section 409A was added to the IRC, effective January 1, 2005, under Section 885 of the American Jobs Creation Act of 2004. Section 409A regulates the tax treatment of "nonqualified deferred compensation" paid by a corporate entity ("service recipient") to all "service providers," which includes executives, general employees, some independent contractors

and board members. The effects of Section 409A are far reaching, because of the exceptionally broad definition of "deferral of compensation."

Typical Process of IRC 409A Appraisals

- **Stage 1- Initial Ground Work**
  - **Information Request-** A detailed information request listing out documents, data required for the valuation analysis- financial statements, business plans, financial projections, certificate of incorporations, shareholder agreements, product descriptions etc.
  - **Client Discussion-** A detailed discussion with the client to understand the business model, stage of development, significant milestones going forward, key value drivers, critical insights, priority of information, timelines, etc.

- **Stage 2- Background Research**
  - **Background Discussion**- Analysis of main lines of operations, product development, key business segments, latest industry scenario, its potential impact on company, addressable market, market position, competitive landscape, etc.

- **Stage 3- Valuation Analysis and Discussion**
  - **Financial Modeling and Valuation-** Prepare a dynamic and integrated business model capturing key financial and operational drivers, important valuation assumptions, benchmarks, industry data, widely recognized valuation approaches – DCF, relative valuation, guideline transactions, exit scenarios, complex capital structures, etc.
  - **Client Discussion-** Detailed discussion with the client on interim valuation analysis for client insights on important valuation assumptions, explain valuation approaches used, benchmarks considered, expected future outcomes, including exit scenarios, etc.

- **Stage 4- Finalization**
  - **Report Writing** - Compilation of all analysis, information, assumptions, estimates, approaches in comprehensive, well documented appraisal report with well-defined sections including certification, objective, company overview, industry overview, economic overview and valuation.
  - **Final Discussion and Appraisal Certificate** - Final discussion on draft appraisal report and issue of signed copy of appraisal report after incorporating client comments and insights.

It should be mentioned, that in cases where required, we help our clients in audit process relating to valuation, by providing written responses to satisfy potential audit queries and setting up discussion with auditors, when needed. Our vastly knowledgeable and experienced analysts will

ensure that your valuation report can successfully pass scrutiny of highest standards.

Valuator's Information:

Sagi Ben-Shlush, owner and CEO of IFS Consulting & Investments (2009) Ltd. Should you have any questions concerning our analysis or report, please contact us at 972-52-476-001 or sagi@ifs-consulting.co.il.

It should be mentioned that our opinion includes the description of the methodology employed and the assumptions on which the valuation is based.

Under no circumstances will we be held liable for any damage, cost or expense incurred in any way or form due to fraud, misrepresentation, deception, misinformation, incomplete or withheld information on the part of the company or any of its representatives, or any actions taken under such circumstances